

Tips on Tips



A Guide to
Tip Income Reporting
**for Employers in the
Food and Beverage Industry**



If you are an employer in the food and beverage industry, this guide is for you.

The Internal Revenue Service (IRS) began its *Tip Rate Determination/Education Program (TRD/EP)* in October 1993 for the food and beverage industry. The objective of the Program has been to improve and ensure compliance by employers and employees with statutory provisions relating to tip income.

The Program of Tip Reporting

What tip reporting options are available?

- Tip Rate Determination Agreement (TRDA)
- Tip Reporting Alternative Commitment (TRAC)
- Continue status quo, i.e., do no more than you are doing now
- Examination of Tip Income Reporting

Under the *Tip Rate Determination/Education Program (TRD/EP)*, the employer may enter into either the TRDA or TRAC arrangement. The IRS will assist applicants in understanding and meeting the requirements for participation. The next pages show how these two arrangements differ.



How does the program benefit the employer?

- No subsequent tip examination as long as a *TRDA* or *TRAC* arrangement is in effect
- Employer credit allowance for FICA taxes paid on tips reported by employees in excess of the minimum wage
- Compliance with the law

How does the program benefit the employee?

- Greater social security benefits
- Increased proof of income when applying for mortgage, car, and other loans
- Increased unemployment benefits
- Increased retirement plan contributions (if applicable)
- Increased workers' compensation
- No subsequent tip examination is imposed as long as terms of the arrangement have been met and all tips have been reported

TRDA vs. TRAC

(how they differ)

TRDA

TRDA requires the IRS to work with the establishment to arrive at a tip rate for the various restaurant occupations.

TRDA requires the employee to enter into a *Tipped Employee Participation Agreement (TEPA)* with the employer.

TRDA requires the employer to get 75% of the employees to sign *TEPAs* and report at or above the determined rate.

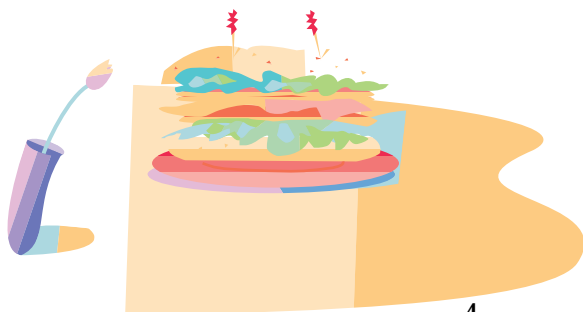
TRAC

TRAC does not require that a tip rate be established but it does require the employer to:

- establish a procedure where a directly-tipped employee is provided (no less than monthly) a written statement of charged tips attributed to the employee.
- implement a procedure for the employee to verify or correct any statement of attributed tips.
- adopt a method where an indirectly-tipped employee reports his or her tips (no less than monthly). This could include a statement prepared by the employer and verified or corrected by the employee.
- establish a procedure where a written statement is prepared and processed (no less than monthly) reflecting all cash tips attributable to sales of the directly-tipped employee.

TRAC does not require an agreement between the employee and the employer.

TRAC affects all (100%) employees.



TRDA

TRDA provides that if employees fail to report at or above the determined rate, the employer will provide the names of those employees, their social security numbers, job classification, sales, hours worked, and amount of tips reported.

TRDA has no specific education requirement.

TRDA participation assures the employer that prior periods will not be examined during the period that the *TRDA* is in effect.

TRDA results in the mailing of a notice and demand to employer for the employer's portion of FICA taxes on unreported tips determined for the six-month period used to set the tip rate(s).

TRDA prevents employer (only) assessments during the period that the agreement is in effect.

TRAC

TRAC provides that if the tip rate does not improve collectively, the *TRAC* may be revoked. If revoked, the employer could be subject to a *TRDA* or tip examination.

TRAC includes a commitment by the employer to educate and reeducate quarterly all directly and indirectly-tipped employees and new hires of their statutory requirement to report all tips to their employer.

TRAC includes the same rules.

TRAC has no validation period. Therefore, no notice and demand is appropriate.

TRAC contains a similar provision.



Example of a TRAC Statement

The following is an example of a statement that an employer can use as required in the TRAC arrangement. This TRAC Statement is given to an employee showing tips attributed to him/her. This example not only fulfills the statement required for charged tips but encompasses indirectly-tipped employee reporting and the reporting of cash tips.

Employer Portion

Employee Name: Mark Doe
 Employee Address: 123 Main Street
 City, State, Zip: Any Town, USA 12345
 Employee SSN: 000-00-0000
 Job Category: Food Server
 Restaurant Name: ABC Bar & Grill
 Employer EIN: 00-0000000
 Report Period: 01/01/96-01/31/96

Gross Sales \$ 6,000.
 Charged Sales w/Tips \$ 2,000.
 Charged Tips \$ 280.
 Charged Tip Rate 14%
 Sales Subject to Cash Tips \$ 4,000.

Employee Portion

Cash Tips \$ 520.
 Cash Tip Rate 13%

Tips Shared w/Others

Name:	Job Category:	Amount:
Johnny Noname	Busser	\$ 120.
Total		(120.)

Tips Received from Others

Name:	Job Category:	Amount:
Susie Cue	Cocktail	\$ 100.
Total		100.

Net tips kept and reported: \$ 780.

Employee Signature: Mark Doe Date: 2/5/96

Employer fills out top portion.

Gross Sales: *only* include food & drink amount. *Do not* include tax, tip, or nonfood/drink items.

Charged Sales: include charged sales that show a tip on food & drink amounts *only*. *Do not* include tax, tip, or nonfood/drink items. (A charged sale with no tip is included as a cash sale.)

Employee fills out bottom portion.

An indirectly-tipped employee would only receive (from the employer) the "title" portion of statement filled out, unless employer captured "tips shared w/ others" information from the directly-tipped employees TRAC Statement and showed it as "tips received from others."

Employee signs statement and gives a copy to employer, retaining a copy for his/her records. This statement would satisfy employer's requirement under the TRAC arrangement and the employee's requirement under the law.

How To Get Your Program Underway

How To Apply

To enter into one of the arrangements, submit an application letter to your area IRS Chief, Examination/Compliance Division, Attn: Tip Coordinator. The Tip Coordinator can provide a letter format as well as extensive information on the two separate arrangements. Check your telephone directory for the IRS office in your area. They can provide the mailing address of the Tip Coordinator.

Who Should Apply

All employers with establishments where tipping is customary should review their operation. Then, if it is determined that there is or has been an underreporting of tips, the employer should apply for one of the two arrangements under the *TRD/EP*.

Employers currently with the *TRDA* in effect may revoke the arrangement and simultaneously enter into a *TRAC*.

When to Apply

An employer may apply for either one of the two arrangements at any time. The effective date of the arrangement is determined by receipt and handling of the employer's application.

TRDA is effective as of the date the IRS District Director signs the arrangement.

TRAC is generally effective as of the first day of the quarter following:

- submission of a *TRAC* application if the application is submitted prior to June 1, 1996, *or*
- the date the District Director signs the agreement if the application is submitted after May 31, 1996.

For More Information

The following is a list of many IRS forms and publications relating to tip income reporting that can be ordered by calling 1-800-829-3676.

Pub 505 – *Tax Withholding and Estimated Tax*

Pub 531 – *Reporting Tip Income*

Pub 1244 – *Employee's Daily Record of Tips and Report to Employer*. This publication includes **Form 4070**, *Employee's Report of Tips to Employer*, and **Form 4070A**, *Employee's Daily Record of Tips*.

Form 941 – *Employer's Quarterly Federal Tax Return*

Form 1040ES – *Estimated Tax for Individuals*

Form 4137 – *Social Security and Medicare Tax on Unreported Tip Income*

Form 8027 – *Employer's Annual Information of Tip Income and Allocated Tips*

Form W-2 – *Wage and Tax Statement*





Department of the Treasury
Internal Revenue Service
Publication 1875 (3-96)

Catalog Number 22212G